BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of SAN GABRIEL VALLEY WATER COMPANY (U337W) for Authority to Increase Rates Charged for Water Service in its Fontana Water Company Division to Increase Revenues by $11,573,200 or 39.1% in 2003, $3,078,400 or 7.3% in 2004, $3,078,400 or 6.8% in 2005, and $3,079,900 or 6.4% in 2006, and	A.02-11-044
In the Matter of the Application of San Gabriel Valley Water Company (U337W) for Authority to Increase Rates Charged for Water Service in its Fontana Water Company Division By $5,662,900 or 13.1% in July 2006, $3,072,500 or 6.3% in July 2007, and $2,196,000 or 4.2% in July 2008.	A.05-08-021

REPLY BRIEF OF THE DIVISION OF RATEPAYER ADVOCATES

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Pursuant to Rule 75 of the Commission's Rules of Practice and Procedure and the schedule agreed to by the parties and adopted in a March 17, 2006 ruling of Administrative Law Judge Barnett, the Division of Ratepayer Advocates ("DRA") hereby files its Reply Brief in the Application of San Gabriel Valley Water Company ("San Gabriel" or the "Company") to increase rates in its Fontana District.

DRA's Opening Brief addressed many of the issues raised by San Gabriel in its Opening Brief. DRA will not reargue issues it has discussed previously save when it is necessary to correct misstatements or inaccuracies in San Gabriel's Opening Brief. The Commission should not interpret DRA's silence on any matter raised in San Gabriel's Opening Brief as support for San Gabriel's position.

I. INTRODUCTION

San Gabriel has not met its burden with "clear and convincing" evidence that demonstrates their proposed rate increases are "just and reasonable." In numerous areas, San Gabriel's showing is wholly inadequate. For example, San Gabriel has not met its burden to justify various capital projects, specifically the Sandhill Plant, a new office building, wells, and reservoirs, certain operating and maintenance, and administrative and general expenses.

The Water Division's Audit, which was ordered in San Gabriel's previous rate case, showed that San Gabriel violated Sections 790, 851, and D.03-09-021 by misappropriating over $27 million. San Gabriel has also deliberately misled the Commission and violated Commission rules. During the evidentiary hearings, San Gabriel misrepresented the amount of water it has available, misstated the Sandhill Project's actual costs, dissembled regarding the need for various plant projects, and engaged in an illegal affiliate transaction.

DRA proposes setting a fine that will deter future violations of Rule One by San Gabriel, and other companies in the Water Industry. San Gabriel cannot be rewarded for actions that have thwarted and attempted to subvert the regulatory process. ALJ Barnett's proposed split of the proceeds of 75% to ratepayers and

25% to shareholders would encourage such wrongful behavior because San Gabriel would be allowed to retain one-quarter of its ill-gotten gains. Therefore, 100% of the Audit proceeds should be assigned to ratepayers as contributions in aid of construction ("CIAC"). After the Commission incorporates the Water Division Audit's recommendation, i.e., refunding 100% of the proceeds to ratepayers, San Gabriel's revenue requirement for Test Year 2006-2007 would be $37,473,300.

A. San Gabriel has failed to show CSI will utilize its full water rights.

San Gabriel disputes DRA's recommendation that estimated sales to CSI be increased by 283,140 Ccf. San Gabriel's proposal would reduce the Company's projected sales to CSI by 50%. The Company's projected reduction is based on the assumption that once CSI finishes the refurbishment of its own wells, it will utilize its full 1,300 acre feet of water rights. DRA agrees that CSI has stated it is rehabilitating its wells. (DRA Opening Brief, p. 7) However, the Company still has not provided any evidence or support for its contention that CSI will utilize its full 1,300 acre feet of water rights, which equates to 566,280 Ccf. San Gabriel has not verified with CSI that CSI will reduce its purchases from San Gabriel by an amount equal to CSI's owned water rights.

DRA continues to recommend that San Gabriel's estimate of future sales to CSI be increased by 50% because San Gabriel has not provided support or evidence for its assumption that CSI will be able to and intends to pump its own water to the full extent of its owned water rights. (DRA Opening Brief, p.8)

II. CHEMICAL EXPENSES

A. Ratepayers should not reimburse San Gabriel in the 2006-2007 Test Year for expenses not incurred during this period.

San Gabriel disagrees with DRA's recommendation that the projected increase in chemical costs associated with the Company's proposed Sandhill upgrade project should be removed from the Test Year. The Company

contends that its witness Daniel Dell'Osa indicated "…it would be unfair to deny San Gabriel any recovery of Sandhill chemical costs for three years just because the project may begin operation a few weeks after the Test Year ends." (San Gabriel Opening Brief, p. 21)

DRA's proposal does not deny recovery of all Sandhill chemical costs since the chemical costs utilized at the Sandhill treatment plant, prior to the proposed upgrade, would still be included in DRA's recommended chemical costs. DRA is only removing the incremental costs associated with the proposed upgrade, which is outside of the 2006-2007 Test Year. In addition, the Company contends that the "…project may begin operation a few weeks after the Test Year ends" is not accurate based on the evidence presented in this case. San Gabriel has indicated that the projected in-service date for the Sandhill Plant upgrade is August 2007. The Test Year ends June 30, 2007, and thus the projected in-service date, assuming no further project slippage, is over a month after the end of the Test Year, *not weeks*.

Lastly, as addressed in DRA's Opening Brief, DRA has significant concerns with the proposed Sandhill Treatment Plant upgrade. Ratepayers should not be required to reimburse San Gabriel in the 2006-2007 Test Year for an expense that the Company does not project incurring during that period. Thus, the Commission should adopt DRA's recommended $128,000 reduction to the projected chemical expense.

III. GENERAL LEGAL EXPENSES

A. The Commission should adopt DRA's recommended 5-year forecast for non-perchlorate legal expenses.

San Gabriel continues to recommend that general legal expenses be based on a 10-year average of costs as opposed to the 5-year average recommended by DRA. (San Gabriel Opening Brief, p. 24-25) San Gabriel utilized the period between 1995 through 2004, inflated to 2004 dollars, in

determining its average legal expenses. DRA thoroughly addressed this issue in its Opening Brief on pages 17-18. San Gabriel contends that "…the variability of legal issues and of legal fees from year to year justifies San Gabriel's reliance on ten years' activity and legal expenditures, allowing a normalized projection of general legal expenses." (San Gabriel Opening Brief, p. 24-25) DRA believes that the use of a five-year average will account for such variability. As pointed out in DRA's Opening Brief on page 17, legal expenses during the two oldest years utilized by San Gabriel in determining its 10-year average are significantly higher than the other years reflected, distorting the average calculation. The legal expense in the oldest year, 1995, at 2004 dollar levels, was $830,684, and the 1996 amount at 2004 dollar levels was $773,223.72. Both of these figures are considerably higher than average expenditures from 1997 through 2004. (Exhibit 84).

San Gabriel contends that in the first 11 months of 2005, the Fontana Division incurred general legal fees that exceeded its estimate. *See id.* Mr. Whitehead agreed that the actual non-perchlorate legal expenses incurred in the first 11 months of 2005 were $323,517. (Tr. Vol. 8, p. 757, Whitehead/San Gabriel) Thus, San Gabriel's 2005 legal expenses were considerably lower than the decade-old numbers for 1995 & 1996 used in the Company's proposed 10-year average calculation. If the actual 2005 legal costs were annualized based on the $323,517 incurred for the first eleven months and used in the determination of the average instead of the 1995 balance of $830,684, the 10-year average would be significantly reduced. The Commission should adopt DRA's recommended non-perchlorate legal expenses based on its 5-year average forecast.

IV. LABOR COSTS

A. Labor vacancies should be reflected in projecting labor costs.

DRA thoroughly addressed labor costs in its Opening Brief on pages 19 – 26 and thus will not restate those arguments. Upon review of San Gabriel's Opening Brief on labor cost issues, DRA stands firm in its recommendations. DRA, however, will address some of San Gabriel's statements made in its Opening Brief with regards to labor costs.

As addressed in DRA's Opening Brief on pages 19 – 20, DRA recommends that vacant positions should be removed. San Gabriel states that "DRA proposed to disallow payroll expense associated with 12 existing employee positions that happened to be vacant at one arbitrary point in time in November 2005." (San Gabriel Opening Brief, p. 28) San Gabriel's Opening Brief also states that Mr. Nicholson believed the "…level of vacancies at the time DRA selected to cut vacant positions was higher than normal for the Company…" These assertions are not accurate.

As of the date of San Gabriel's initial filing, it had 13 vacancies. As of November 14, 2005, San Gabriel had 12 vacancies. (Ex. 45, p. 3-7) As of January 16, 2006, San Gabriel had only hired one additional employee. (Ex. 50) The Company has not presented any evidence that demonstrates that the level of vacancies forecasted by DRA is not reflective of normal vacancies levels. In fact, when asked during hearings, Mr. Nicholson indicated that he was not sure of any changes in vacancies, with the exception of one retirement, from the November date used by DRA in its adjustment during the hearings. (Tr. Vol. 4, p. 306 – 307, Nicholson/San Gabriel)

In addition to reflecting zero vacancies, San Gabriel has proposed the addition of twelve new employees for the Fontana Division. San Gabriel states that each of its new employee positions it proposes are needed and that "No

substantive case has been made for disallowing any of them." (San Gabriel Opening Brief, p. 31) DRA strongly disagrees.

DRA recommends that 5 of the 12 proposed positions be removed and that four of the remaining Water Treatment Operator III positions be recovered through advice letter. Pages 20-24 of DRA's Opening Brief details the reasons and substantiation for DRA's recommended disallowances and thus DRA will not reiterate those arguments here. However, the Commission must be mindful of San Gabriel's record of not completing construction projects it proposed in its last Fontana rate case.

V. INCOME TAXES

A. There is a definite tax benefit San Gabriel will realize during this GRC.

In addressing the impacts of the American Jobs Creation Act of 2004 on income tax expense, specifically on the qualified production activities income deduction, San Gabriel continues to recommend that the impacts not be reflected in this case. The 2004 Act is already in effect, and was in effect for tax years 2005 and beyond. (DRA Opening Brief, p.33) Since the tax benefits are already in effect, they will clearly affect expenses in the 2006-2007 Test Year. San Gabriel indicates it agrees that "…there could be a tax benefit." (San Gabriel Opening Brief, p. 39)

This statement is misleading in its use of the term "could" because there is a definite tax benefit that San Gabriel will realize that should be reflected in this case. DRA discussed this issue in detail, in its Opening Brief on pages 32 – 34. The notion that San Gabriel "could" receive this benefit is simply sophistry and should be recognized as such. The appropriate term to use is "shall", i.e., San Gabriel "shall" receive this tax benefit because it reflects codified federal law.

VI. COMPONENTS OF RATE BASE

San Gabriel states it requires major investments in new operating plant for water production, treatment, storage and distribution to assure safe and reliable

water supplies for customers. It adds that the reasons for the investments are moderate population growth, unpredictable fluctuations in temperature and rainfall, and significant water quality problems. (San Gabriel Opening Brief, p.5)

San Gabriel then states that "San Gabriel is not seeking prior approval of its investment plans" in this proceeding. They continue by stating that the controversy in this General Rate Case is not over any request by San Gabriel for a guarantee of cost recovery, but rather over the appropriate forecasts of rate base. (San Gabriel Opening Brief, p. 42)

Contrary to San Gabriel's position, its budget and/or rate case requests do not necessarily reflect just the needs of the Company, but also include contingent plant. (Ex. 45, p. 8-4) For example, San Gabriel maintains that proposed improvements to site F15 are its second most important capital improvement (according to Company testimony), but the proposed project is not scheduled until 2007. (Ex. 45, p. 8-4/5)

The Company is requesting three wells for site F51 in 2006, but the same three wells were requested in 2003 in A.02-11-044 and approved in D.04-07-034. Additionally, San Gabriel has not acquired land for the proposed wells at sites F21 and F54. (Ex. 45, p. 8-7/8) The Company requested the reservoir for site F51 in A.02-11-044, and the plan to construct it in 2003 was approved under D.04-07-034. San Gabriel is now requesting the reservoir again. (Ex. 45, p. 8-12/13) How many times does San Gabriel expect its ratepayers to reimburse it for the same project?

And in D.04-07-034, San Gabriel requested and was allowed four emergency generators. San Gabriel's response to Data Request GRC-007-39 indicates that San Gabriel has not acquired a generator since the year 2000. Thus, the Company's request for nine generators is excessive under the circumstances and once again proves that a request for an addition to plant that even if allowed, and is based on a perceived need, does not guarantee San Gabriel will make such acquisitions. (Ex. 45, p. 8-14)

The Company requests Advice Letter recovery for its Sandhill project because the timing and/or cost of project are difficult to forecast with reasonable certainty. Specifically, the cost of the Sandhill Plant and the in-service date is not known and measurable. And it is uncertain what the ultimate amount of additional supply will result from the Sandhill Plant upgrade. (Ex. 45, p. 8-15/16)

In A.02-11-044, San Gabriel contended that it could not put on hold construction of seven requested treatment plants while waiting for litigation proceeds. The Commission did approve the request for the seven facilities, but San Gabriel failed to construct the facilities. (Ex. 45, p. 8-17) Thus, San Gabriel's credibility about its stated construction intentions has been suspect for at least two rate cases.

San Gabriel is requesting recovery for plant ***prior*** to construction and prior to investments being made. DRA has concerns regarding San Gabriel's request for funding authorization when: 1) the use and usefulness of proposed plant in question has not been established; 2) San Gabriel's request for recovery of plant that has yet to be constructed at currently-owned facilities; 3) its request for funding for proposed plant on vacant land owned by San Gabriel; and its request for 4) proposed plant not yet constructed on land yet to be acquired or even contracted for. As noted in DRA's Opening Brief, p.47-56, in A.02-11-044 San Gabriel requested funding for additional capital projects, that were approved for construction in the last rate case. San Gabriel's inaction subsequent to D.04-07-034, clearly indicate that San Gabriel's requests are based more on want than need. Why should San Gabriel be compensated twice for plant that it may or may not build depending upon its caprice? Ratepayers should not be twice burdened for facilities that may never be built.

A. Supply

The Company's discussion on water supply references Mr. Johnson's testimony, stating that there are different weather patterns for northern and southern California and that when there are severe droughts in southern California,

it's not unusual for southern California's supply to be significantly augmented by surplus water from the State Water Project. (San Gabriel Opening Brief, p.45) Mr. Johnson suggests that the State Water Project can be relied upon, but Mr. LoGuidice, another Company witness, disagrees. He stated San Gabriel cannot rely upon water from the State Water Project to be available every summer, day-in and day-out. (Tr. Vol. 3, p. 204, LoGuidice/San Gabriel)

The Company states that the Cucamonga Valley Water District interconnection is necessary to increase water supply reliability, create new supply sources, and decrease vulnerability during water supply emergencies. (San Gabriel Opening Brief, p. 48) Water supply emergencies occur at different times for different reasons, but peak demand particularly occurs during drought conditions. However, under cross-examination, Mr. LoGuidice stated that the connection could not be relied upon to meet water demands from June through November and that he would not consider it to be a reliable source of water to meet peak demand. (Tr. Vol. 3, p. 180, LoGuidice/San Gabriel)

The connection's limited availability or reliability illustrates that San Gabriel has not established the need for the facility. DRA has not removed the cost from plant, but if the Commission considers doing so, San Gabriel's lack of confidence in the reliability of the connection to meet demand may justify excluding the cost from plant.

B. Plant Additions

San Gabriel's discussion on plant additions criticizes the supply and demand disparity the Fontana School District and the City of Fontana introduced during the evidentiary hearings. Specifically, San Gabriel disputes the inclusion of wells it considers unreliable. Nonetheless, the City and School Districts the evidence they provided on the contribution of these wells to supplies was not rebutted by San Gabriel. San Gabriel states it was correct for it to assume that there would be a loss of wells in the Lytle Creek Basin in its projections and that it used the Lytle Creek wells to meet the 2005 peak demand because 2005 was one

of the wettest years on record and somewhat cooler. (San Gabriel Opening Brief, pp. 50-52)

However, the Company ***fails*** to recognize that Attachment 5 to Mr. LoGuidice's Rebuttal Testimony identifies seven of the eleven Lytle Creek Basin wells and all four of the Colton/Rialto Basin wells as sources of supply used to meet the maximum peak day demand on August 11, 2004, which was a drought year. (Ex. 21) Mr. LoGuidice stated 2004 had the worst drought in the last one hundred years or so. (Tr. Vol. 2, p. 144/145, LoGuidice/San Gabriel) Thus, Mr. LoGuidice and the Master Plan supported by Mr. Johnson's testimony, refuse to recognize the Lytle Creek Basin and Colton/Rialto Basin wells as reliable sources of supply even though the wells were available to meet the peak day demand requirements in 2004, which the Company has consistently stated was the worst drought year in the last one hundred years or so. San Gabriel's contradictory testimony alone makes its position suspect, particularly when contrasted with the testimony offered by the City

C. Sandhill Plant

Mr. Diggs explained that the planned upgrades and pretreatment facilities at the Sandhill Plant will restore the full usefulness of the plant because the plant will be able to process State Water Project water. (San Gabriel Opening Brief, p. 58) And Mr. LoGuidice explained that the proposed upgrades will enable the Sandhill plant to treat Lytle Creek surface water under all conditions, and will eliminate the blending requirement for State Water Project water, thus allowing treatment of greater quantities of State Water Project supplies. (San Gabriel Opening Brief, p. 59) San Gabriel states that meeting maximum day demand is not the primary justification for investment in the Sandhill Plant, but rather it is needed to serve baseload production. (San Gabriel Opening Brief p.63) The Company also contends that DRA agrees with San Gabriel that the use of advice letters is proper in recovering the costs of the project. (San Gabriel Opening Brief, p. 65) DRA,

however, does not agree that it is proper to use advice letters in regards to the Sandhill project.

Mr. LoGuidice stated that San Gabriel cannot rely upon water from the State Water Project to be available every summer, day in and day out. (Tr. Vol. 3, p. 204, LoGuidice/San Gabriel) He added that the Company did not have a contract in place for State Project Water for the Sandhill Plant, but the Inland Empire Utilities Agency assured San Gabriel orally that water will be available in quantities sufficient to meet San Gabriel's needs. (Tr. Vol. 3, p. 211/212, LoGuidice/San Gabriel)

According to the Master Plan (p. 98), the water demands under normal weather conditions are estimated to be 54,000 AFY in the short-term (2010), and with a water conservation program, demand is estimated to be 51,300 AFY in the short term. As shown on Attachment B, attached to DRA's Direct Testimony, the production available as of April 11, 2005 was 59.0 MGD or 66,246 AFY. (Ex. 45, p.8-8) Thus, the average daily requirements can be met with the current system. San Gabriel's contention that the Sandhill upgrades are required to meet the daily requirements is incorrect.

Again, San Gabriel mischaracterized DRA's views on the Sandhill Plant. DRA recommends that the cost of the Sandhill Plant be excluded, the Company not be allowed to recover the cost through an advice letter, and the final cost and usefulness should be determined in the next GRC. (Ex. 45, p. 8-16/17; DRA Opening Brief, p.46-47)

Lastly, San Gabriel claims the Sandhill Plant is needed to meet baseload and because it relies on the State Water Project water as a source for the plant to provide that baseload. (San Gabriel Opening Brief, p. 63) The Company, however, currently has sufficient supply to meet its baseload (i.e. demand under normal weather conditions), and the Company does not have any contractual guarantee that State Water Project water will be available to utilize the increase in capacity at the Sandhill Plant. Absent such a contract or other adequate

justification for an increase in capacity to meet baseload requirements, San Gabriel should not be allowed recovery of the plant in the current GRC or by advice letter treatment. San Gabriel has failed to meet its burden of proof demonstrating the need for this project.

VII. WATER DIVISION AUDIT REPORT

A. RECORDKEEPING-ACCOUNTING TREATMENT OF PROCEEDS

1. Accounting principles and income tax rules are not controlling as applied to the ratemaking treatment of proceeds.

Mr. Batt stated San Gabriel handled its sales to private owners, condemnation, service duplication, and contamination proceeds properly by following income tax rules and generally accepted accounting principles. (San Gabriel Opening Brief, p.129) Accounting principles and income tax rules, however, are not controlling when applied to the ratemaking treatment of the proceeds. (Exhibit 63). As the Water Division stated in its Audit Report, in D.94-01-028, the Commission discussed the accounting treatment for ratemaking purposes regarding the Suburban Water Systems' sale of land. *See id.* The Commission will go beyond the Uniform System of Accounts whenever they believe it is necessary to strike a proper balance between the interests of ratepayers and shareholders. Id.

B. APPLICATION OF SECTION 851

1. San Gabriel violated Section 851.

Mr. Batt argued that San Gabriel did not need to seek Section 851 approval on condemnations because in each case, San Gabriel had acted pursuant to an engineering memorandum documenting the status of the property as "no longer necessary or useful to the company in the performance of its obligations as a public utility." (San Gabriel Opening Brief, p.159-160) San Gabriel's ignorance of applicable law or its misinterpretation of the law does not excuse its failure to comply with Section 851. Relying on engineering reports that deemed properties

as being no longer necessary or useful solely because they were threatened by condemnation as justification for not seeking the Commission's Section 851 approval was inappropriate.

C. SOURCES OF GAIN- SERVICE DUPLICATION

San Gabriel states that the Water Division found the $2,314,538 service duplication damages from the City of Fontana as "subject not to Section 790 but, surprisingly, to Section 851," and refers to Page 23 of the Audit Report. (San Gabriel Opening Brief, p.141) San Gabriel's statement, however, is inaccurate because on Page 23 of the Audit Report, the Water Division states Section 851 and not Section 790 governs the $1,500,000 of the Los Angeles County service duplication proceeds. The Water Division's Audit Report did state Section 790 does not govern the $2,314,538 of service duplication damages from the City of Fontana, but on Page 23 of the Report, it states Section 851 governs the $1,500,000 of the Los Angeles County service duplication proceeds. San Gabriel, appears to have confused the Fontana and Los Angeles service duplication amounts in regards to the Audit Report's conclusions.

1. San Gabriel's shareholders should not be allocated the service duplication proceeds.

In addition, Mr. Whitehead testified that whether or not the Commission determines the service duplication damages qualify under Section 790 or not, he disagreed with the Water Division's finding that the proceeds should go to the ratepayers. He testified that the proceeds should go instead to San Gabriel's shareholders. (San Gabriel Opening Brief, p.140-43) Ultimately if service duplication does occur, the expense is still placed upon ratepayers because whenever rate base is increased, ratepayers are the ones that are specifically affected. Ratepayers will have to pay higher rates because of service duplication

D. APPLICATION OF SECTION 790

1. Section 790 requires a utility to track proceeds in a manner that ensures proceeds have been invested in Section 790 plant.

San Gabriel argues that "It is the ***amount*** of net proceeds- not the precise dollars received- that San Gabriel has tracked and documented, as required by Section 790…" (San Gabriel Opening Brief, p.158) As argued by San Gabriel, this distinction defies logic since most would agree whether the idea is "amount" or "precise dollars," such proceeds should be tracked in a memorandum account or in a manner that ensures proceeds are spent and accounted for as San Gabriel claims they have been in Section 790 plant. The specious distinction San Gabriel attempts to draw between the "amount of net proceeds and the precise dollars received" does not excuse San Gabriel's wholesale failure to properly account for the proceeds it received from its sales of property.

E. RECORDKEEPING- ACCOUNTING

1. Calling a regulatory requirement a "hassle" does not excuse non-compliance with a long-established Commission practice.

San Gabriel states in regards to ensuring that rates do not reflect any revenue requirement associated with the $2.6 million investment, it would be a "major hassle to do so." (San Gabriel Opening Brief, p.158) It claims that restating its financial statements for prior years to classify as CIAC the $2.6 million investment in Plant F10 is a "hassle" because San Gabriel had already sent the financial statements to financial institutions and shareholders. *See id.* The "hassle" appears to be negligible when one looks at the benefit received by financial institutions gaining essentially updated financial statements. Moreover, something being a "hassle" is thin thread on which to hang San Gabriel's justification for its actions. A lot of what a water utility's regulatory staff does is a "hassle"; indeed San Gabriel recovers regulatory expenses from its ratepayers to cover such "hassles." San Gabriel is well aware of its obligations to comply with

various regulatory requirements imposed by the Commission—calling something a "hassle" excuses none of these requirements.

F. RECORDKEEPING- PAYMENT OF DIVIDENDS

1. San Gabriel provides dividend payments from retained earnings, which include net income, other items, and gain on sale of property rights.

San Gabriel states that Mr. Batt's testimony stressed the importance of a corporation having a consistent dividend policy and noted that San Gabriel's historical practice has been to pay dividends equaling 6% of average common stock equity. (San Gabriel Opening Brief, p.174)

Mr. Loo states in his Reply Testimony regarding dividend payments that common stock equity is made of: 1) common stock; 2) capital surplus; and 3) retained earnings. (Exhibit 64, p.3) And San Gabriel's retained earnings are comprised of: 1) net income; 2) other items; and 3) gain on sale of property rights. Therefore, retained earnings include other items beside San Gabriel's earnings from operations, such as proceeds received from water contamination lawsuit settlements. Id.

If San Gabriel's historical practice is to pay dividends equal to approximately 6% of average common stock equity, proceeds received from other sources such as contamination lawsuit settlements will increase the amount of dividends to be paid in the year the proceeds are received. Thus, the level of dividend payments increases by these other items included as part of retained earnings and common stock equity. Id.

Lastly, Mr. Whitehead "confirmed that, while extraordinary items like capital gains or contamination settlements may be included in retained earnings, they are forbidden by the Trust Indenture from being part of the **unrestricted** retained earnings from which dividends may be paid." (San Gabriel Opening Brief, p.177) San Gabriel's point here is interesting in that the Water Division

believes this is the first time it has heard San Gabriel use the phrase "unrestricted retained earnings."

Throughout the Water Division's review of San Gabriel's accounts during the Audit, San Gabriel has not provided any dividend schedule that separates retained earnings into *restricted* and *unrestricted*, and which excluded the restricted amount when calculating average common stock equity to apply their historical 6% dividend practice in calculating dividends. Thus, asserting now that contamination settlements cannot be included in the "unrestricted" retained earnings, where dividends are paid from, is highly questionable since this is subsequent to the Water Division's past review of San Gabriel's accounts, which did not make a distinction between "restricted" and "unrestricted." Is San Gabriel now claiming it does have separate accounts for "restricted" and "unrestricted" retained earnings? If so, why did San Gabriel not provide these accounts to the Water Division during its review? Given this lack of evidence, the only conclusion one can properly draw is that San Gabriel has indeed used condemnation and property sale proceeds to help finance its generous dividend payments.

G. CONTAMINATION SETTLEMENT PROCEEDS

1. Under General Order 103, San Gabriel has an obligation to provide safe water supplies.

Throughout its Opening Brief San Gabriel asserts that contamination settlement proceeds should accrue to the shareholders since the litigation benefited the ratepayers without any risk borne by the ratepayers themselves during the process. (San Gabriel Opening Brief, p.144-150) Mr. Dell'Osa testified that ratepayers have no reasonable claim to the remaining proceeds from contamination settlements. Id. at 149-150.

General Order 103, however, requires water utilities to provide safe water supplies to their ratepayers. Under Standards of Service- Quality of Water and Water Supply:

> "Any utility serving water for human consumption or for domestic uses shall provide water that is wholesome, potable, in no way harmful or dangerous to health and, insofar as practicable, free from objectionable odors, taste, color and turbidity… Water supplied by any utility shall be: (a) Obtained from a source free from pollution; or obtained from a source adequately purified by natural agencies; or adequately protected by artificial treatment."

Thus, if a utility must litigate and fight polluters in court to provide safe water to its ratepayers, there is no reason why excess proceeds from contamination lawsuits should accrue to shareholders when the utility is essentially just fulfilling its obligation as a public utility. Public utilities should not be rewarded for simply "doing their jobs." Excess contamination proceeds should accrue 100% to ratepayers.

H. ALLOCATION OF PROCEEDS

The Company states that the Audit Report did not consider "the legal and expert consultant costs incurred by San Gabriel in obtaining the proceeds at issue and the income taxes that ***must be*** paid". (emphasis added) (San Gabriel Opening Brief, p.181) The Company cites Mr. Loo's testimony agreeing that the legal and consulting costs for the Mid-Valley Landfill settlement should be netted against the settlement proceeds. San Gabriel then states that the legal costs in question "were never" recovered through rates. (San Gabriel Opening Brief, p. 182) However, San Gabriel has presented no evidence to support this position.

The Company then reiterates its position that if the Commission intends to allocate the proceeds in question, then it is necessary to deduct the related legal expenses and "the income taxes that ***must be*** paid". (emphasis added) (San Gabriel Opening Brief, p.183) It adds that it is ***obligated to pay*** those income taxes. (emphasis added) (San Gabriel Opening Brief, p. 184) In a later discussion, regarding the proceeds, however, San Gabriel states that legal fees and other litigation expenses incurred in achieving a favorable settlement with San

Bernardino County were not borne by rate payers. (San Gabriel Opening Brief, p. 188)

DRA has not offset the proceeds for the legal costs that San Gabriel claims should be used to reduce the proceeds. The Company is correct that the legal costs in question have not been ***specifically*** recovered in rates from ratepayers. They have not been recovered in rates because when rates are set, San Gabriel uses a historical average to determine an amount that should be included in rates. However, if the legal costs in question are included in the average developed and incorporated in rates, then the costs are technically included in rates.

The legal costs in question are the same costs included in the Company's requested 10-year average of non-perchlorate related outside legal services expense requested in this proceeding. (Ex. 84) Additionally, the legal expense would have been included in the determination of the appropriate base rates for San Gabriel in prior rate cases. (Tr. Vol. 6, p. 520-521, Charvez/DRA) In fact, in the prior Fontana Division rate case, Application 02-11-044, the Commission's Decision 04-07-034 dated July 8, 2004 specifically stated at page 22, that "San Gabriel analyzed its outside legal costs over a 10-year period to develop an average, normalized estimate applicable to Fontana Division." The Commission adopted San Gabriel's estimate that utilized the same costs that San Gabriel is now trying to use as an offset against the proceeds addressed in the audit report. Thus, the costs have effectively been incorporated in rates in a prior case and are being used again in this proceeding in determining a level of legal costs to be recovered in future rates.

The Company's brief repeatedly states that the taxes must be paid and it states that the Company is obligated to pay the taxes on the various proceeds at issue. San Gabriel does not state that the taxes on the proceeds have in fact been paid and there was no evidence presented in the proceeding that the taxes were in fact paid. In fact, the Company's recommended approach is neither flow-through nor normalized accounting because it recognizes taxes as expenses that have not

been paid without recognizing the deferred income tax treatment realized from recognizing the tax expense.

As evidenced and discussed in detail in R.01-09-001 on pages 96-146, the Commission's policy on income taxes is to use flow-through accounting with the exception of Federal accelerated depreciation and the California Corporate Franchise Tax. Flow-through accounting for income taxes recognizes the tax when the tax is paid. San Gabriel has presented no evidence that taxes on the proceeds have in fact been paid or if they will ever be paid.

Given the precedent established in R.01-09-001, DRA recommends that the Commission apply its policy to use flow-through accounting for income taxes. The Commission should only recognize the taxes once San Gabriel has actually paid them. DRA's testimony in Exhibits 86b and 87b reflects zero taxes in the determination of the net proceeds to be credited to ratepayers in the form of CIAC as suggested by ALJ Barnett. DRA recommends that if the Commission adopts the Company's request to recognize the impact of income taxes in its determination of net proceeds reflected in CIAC, the Commission should recognize normalization accounting and that an offset to rate base be reflected for the deferred income taxes that may be paid in the future.

DRA recommends the adoption of normalization accounting if the Commission allows San Gabriel's tax request because San Gabriel's approach ignores both the flow-through and the normalization approach by only recognizing income taxes as an expense that has not been paid. Normalization treats the tax expense as a reduction to the amount that would be put into CIAC by reducing rate base, but then takes the tax amount and reflects it as a separate deduction to rate base as a deferred income tax credit. It essentially has the same impact that the flow-through method DRA recommends has because the reduction to rate base is the same, except that it has two items (CIAC and deferred income taxes) instead of one (CIAC).

PROPOSED FINDINGS OF FACT

1. San Gabriel's forecasts of customer levels projected by customer class are reasonable and consistent with the guidance under D.04-06-018.
2. The average use per customer proposed by San Gabriel for the residential, commercial, industrial-small and public authority large and small customer classes were projected based on the New Committee Method required under D.04.06-018.
3. The projected sales to Cemex, a large industrial customer, are understated in San Gabriel's filing and should be increased from 223,666 Ccf to 250,685 Ccf, resulting in an increase in revenues at present rates from $269,000 to $313,600, an increase of $44,600.
4. San Gabriel has not supported its full projected decrease in sales to CSI of 566,280. DRA's recommendation that 50% of the reduction, or 283,140 Ccf, should be added back in, increasing 2006-2007 revenues at present rates by $435,800, is reasonable based on the evidence presented in this case.
5. San Gabriel has not demonstrated that the grant revenues it received in 2005 of $116,909 are not reflective of an annual level.
6. San Gabriel has not forecasted that the Sandhill treatment plant upgrade will be in-service during Test Year 2006-2007.
7. San Gabriel has not supported an increase in transportation expense beyond the application of the non-labor escalation rates.
8. San Gabriel has not demonstrated that the outside services costs in Accounts 761, 763, and 755 vary directly with quantities of physical plant.
9. It is not reasonable to project non-perchlorate related legal expenses based on cost levels incurred a decade ago.
10. A five-year average expense level for non-perchlorate related legal expenses is reasonable for projecting the costs going forward.
11. Labor vacancies are a normal occurrence that should be reflected in projecting labor costs.
12. San Gabriel has supported three new positions for inclusion in base rates and four new positions, which should be added via Advice Letter only when and if the proposed Sandhill Treatment Plant Upgrade is placed into service.
13. The most recent experience modification factor for San Gabriel for its workers compensation insurance was 92%.

14. San Gabriel has received refunds of workers compensation expense payments in each of the last three years.

15. San Gabriel will receive an income tax deduction associated with qualified production activities income as a result of the American Jobs Creation Act of 2004.

16. The Company has requested $12,000,000 in rate base and Advice letter treatment for the remaining yet to be determined cost for construction.

17. The Company's request is not for added capacity to meet peak demand, but for baseload capacity.

18. The projected cost for the Sandhill Plant according to San Gabriel is $38 million and the latest projected in-service date is now August of 2007. This date is beyond the 2006/2007 Test Year.

19. The cost and use and usefulness of the Sandhill Plant upgrade is not known and measurable at this time.

20. San Gabriel has not demonstrated that additional baseload capacity is needed and/or justified.

21. The Company's request for eight additional wells is based on its alleged inability to meet its peak demand during drought conditions.

22. San Gabriel assumed the worst case scenario with the demand and supply requirements by eliminating wells the Company classified as unreliable in its supply determination and basing its demand on drought conditions.

23. Despite the Company's claim certain wells were deemed unreliable, the wells did in fact serve as sources of supply during the 2004 drought year, which was the worst drought year in 100 years.

24. San Gabriel has not demonstrated its need for eight additional wells. The one additional well DRA recommends will, along with the current wells in service, provide a sufficient amount of supply to meet the Company's projected short-term needs.

25. The Company has requested eight additional reservoirs to meet demand and meet requirements within specific pressure zones. The Company's request included reservoirs that were not within the areas the Company identified as having inadequate pressure. San Gabriel's request for eight additional reservoirs is overstated by 4 reservoirs. DRA's recommendation to allow additional reservoirs at plants F7, F44, F48 and one at either F15 or F16 is sufficient.

26. San Gabriel has requested the addition of boosters and equipment at various sites where wells and/or reservoirs have been requested.

27. San Gabriel needs one additional well and four additional reservoirs.

28. The Company has not demonstrated a need for all of the requested boosters and equipment. The Company should be allowed recovery of boosters and equipment at the plants F7, F44, F48 and at either F15 or F16.

29. San Gabriel's request for a SCADA system is reasonable and required.

30. The Company's proposed spending for security is necessary and reasonable.

31. San Gabriel's request for nine new generators is excessive and not supported by the record. The Company requested and was allowed four generators in A.02-11-044, but did not acquire the generators. The Company has not acquired a generator since 2000 and has only utilized emergency generators nine times since 2002. DRA's recommendation is to allow five generators provided that San Gabriel documents their purchase is reasonable.

32. The Company's request to include the cost of a new office and operations center through Advice Letter treatment is not justified and/or reasonable. San Gabriel did not provide evidence of the cost of the facility and it did not demonstrate that it would be used and useful. San Gabriel has not begun construction on the new office/operations center and the cost and in-service date is not known.

PROPOSED CONCLUSIONS OF LAW

1. Section 790 governs the $507,199 San Gabriel received during 1996-2004 for the sale of abandoned property to private owners.

2. Section 790 does not govern the $2,520,148 San Gabriel received during 1996-2004 for condemnation proceedings.

3. Section 790 does not govern the $2,314,538 San Gabriel received during 1996-2004 for service duplication.

4. Section 790 does not govern the $8,559,863 San Gabriel received during 1996-2004 for contamination settlements.

5. Section 851 governs San Gabriel's condemnation proceeds received during 1996-2004.

6. San Gabriel violated Section 851 in its treatment of condemnation proceeds.

7. San Gabriel violated Section 790 in its inadequate accounting of its proceeds received from sales of abandoned property to private owners by not utilizing either a memorandum account or some other equivalent record keeping system.

8. Because San Gabriel's condemnation proceeds are governed by Section 790, it violated Section 790 with its inadequate accounting of the proceeds by not utilizing either a memorandum account or some other equivalent record keeping system.

9. Because San Gabriel's service duplication proceeds are governed by Section 790, it violated Section 790 with its inadequate accounting of the proceeds by not utilizing either a memorandum account or some other equivalent record keeping system.

10. Because San Gabriel's contamination settlement proceeds are governed by Section 790, it violated Section 790 with its inadequate accounting of the proceeds by not utilizing either a memorandum account or some other equivalent record keeping system.

11. San Gabriel violated Decision 03-09-021 in numerous ways.

12. San Gabriel violated Rule 1 of the Commission's Rules of Practice and Procedure, as demonstrated during evidentiary hearings, by misrepresenting its actual water supply, the Sandhill Project's actual costs, and the need for various plant projects, and their involvement in an illegal affiliate transaction.

13. The Commission institutes a fine of $500,000 against San Gabriel to serve as an effective deterrence to the water industry and San Gabriel.

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Respectfully submitted,

/s/ SELINA SHEK

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April 14, 2006

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of **REPLY BRIEF OF THE DIVISION OF RATEPAYER ADVOCATES** in **A.02-11-044 etal.** by using the following service:

[X] **E-Mail Service:** sending the entire document as an attachment to an e-mail message to all known parties of record to this proceeding who provided electronic mail addresses.

[ ] **U.S. Mail Service:** mailing by first-class mail with postage prepaid to all known parties of record who did not provide electronic mail addresses.

Executed on April 14, 2006 at San Francisco, California.

/s/ ANGELITA MARINDA
Angelita Marinda

N O T I C E

Parties should notify the Process Office, Public Utilities Commission, 505 Van Ness Avenue, Room 2000, San Francisco, CA 94102, of any change of address and/or e-mail address to insure that they continue to receive documents. You must indicate the proceeding number on the service list on which your name appears.

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